HOW DID DECOUPLED BECOME COUPLED? :INDIA'S MIRACLE GROWTH DROPS

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A year ago, India seemed to be firmly on the path of rapid and sustainable economic growth. Its real GDP growth averaged at 7.2 per cent in 2000–08 and 9.1 per cent in the sub-period 2005–08, which was the second highest after China among large emerging economies and significantly higher than the world GDP growth. The amazingly growing industrial production, service sector, corporate profitability and competitiveness, inflows of foreign investment, stock markets, foreign exchange reserve, overseas acquisitions and investments, exports, etc., marked India's ascendancy to the status of a 'miracle economy'[2].

However, even before the story of Indian miracle took its root, came the bursting of the asset bubble in the United States, collapse of western financial institutions and rising insolvency of the global corporate giants. The combination of these factors resulted in damaging consequences for financial and real sectors across countries. Capital markets and commodity prices witnessed sharp downward trends and liquidity in the economic system was badly hit. The negative impact of the global financial crisis is now appearing to be rapidly spilling over to the real sector of the world economy. Slowing industrial production, falling exports, rising unemployment, dwindling consumer confidence and slowing investment seriously have been affecting economic growth in both developed and developing countries.

Given these disturbing features of the world economy, there has been a fear of reversal of India's miracle growth with a deepening slowdown led by deteriorating savings and investment, slowing consumer spending, scrambling fall in exports and foreign investment inflows, etc. This is despite the alternative expectation that India might be

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[2] Huang, Y (2008) 'The Next Asian Miracle', *Foreign Policy*, July–August.

relatively decoupled from the impact of global crisis due to strong domestic demand and low export dependency. However, contrary to such an expectation, the recent trends of Indian economy show that the country is quite vulnerable to the negative shocks of the global economic crisis. This is partly because of a closer integration of Indian financial markets with global markets and the capability of global factors seriously checking growth and investment spending in export-oriented sectors like information technologies, jewelry, pharmaceuticals, automotive sector etc. Though the longer-term impacts of the global crisis on Indian economy are difficult to predict immediately but it will be worthwhile to examine its preliminary economic impacts.

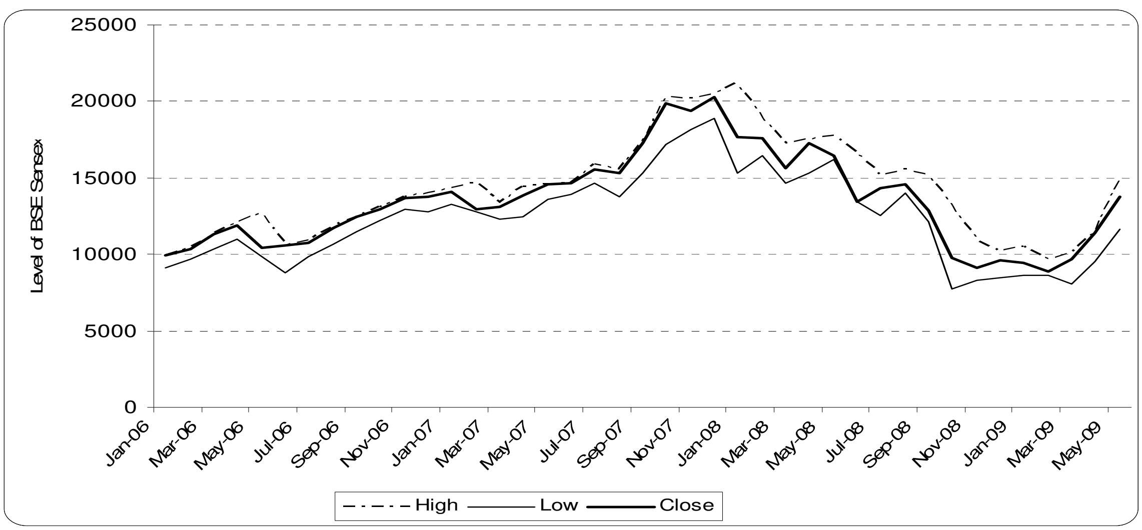
Impacts on Indian Financial Sector

The global financial crisis appears to have affected the Indian financial sector in different magnitudes over sub-sectors. Its adverse impact has been estimated to be marginal on the banking sub-sector given that Indian banks had limited indirect exposure to the failed global institutions or the troubled financial instruments. The RBI sources in November 2007, without providing details, indicated that Indian banks had insignificant exposure to the US sub-prime mortgage and predicted minor impact on the books of banking entities[3]. It becomes clear that a number of Indian banks, namely the ICICI Bank, State Bank of India (SBI), Bank of Baroda, and Bank of India with overseas branches, have exposure to distressed financial instruments and financial institutions. In October 2007, the Ministry of Finance source has put the loss of Indian banks at $2 billion[4]. Among Indian banks, the ICICI bank has disclosed the biggest mark-to-market (MTM) loss of $264 million in March 2008 on account of its investments in derivatives contracts based on subprime loan repayment[5]. The MTM provision of SBI and Bank of Baroda to cover their losses on subprime exposure respectively stands at $10 million and $5.3 million[6]. These losses as compared to the size of the balance sheet of Indian banks appear to be quite small, e.g., ICICI has a balance sheet of $100 billion and that of SBI is $200 billion.

[3] *Business Standard* (2007) 'Sub-prime not to impact banks: RBI', November 28.
[4] *Hindu Business Line* (2007) 'Banks' loss due to sub-prime crisis put at $2 b', Saturday, Oct 06.
[5] Bloomberg (2008) 'ICICI Bank Loses $264 Million on Overseas Investments', March 4.
[6] *Financial Express* (2008) 'SBI net rises 48%' May 03; Business Standard (2008) 'BoB provisions for sub-prime losses', March 6.

The global financial crisis however appears to have a significant negative impact on other financial sub-sectors like Indian equity, money, foreign exchange and credit markets. Following the emerging global problem, the Indian stock market took a turnaround from boom to steep downfall in 2008. India's benchmark equity index, Sensex, had sharply fallen by 44 per cent by February 2009 from its highest level closed in December 2007 (Figure-1). The global liquidity crisis and depressed overseas equity markets have driven away foreign institutional investors (FIIs) from Indian market with net FII outflow of Rs 47,706.2 crore ($9260.6 million) till March 30 in 2008–09[7]. The collapse of the Indian equity bubble with increased volatility in asset prices eventually led to cessation of many initial public offerings (IPOs) and rights issues and substantial capital losses to the household sector. Depressing stock market has essentially choked an important financing source for Indian companies and led to slowdown in business and consumer expenditure.

Figure-1 Trend in BSE Sensex



The continued and heavy outflows from FIIs introduced sudden and sharp reversals in the value of Indian currency. Budging the past trend of appreciation, the Indian rupee has seen a steady decline against the US dollar of 28 per cent during April 2008–March 2009. This sudden depreciation of the rupee caught many export-oriented Indian companies,

[7] *Business Standard* (2009) 'FII outflow close to Rs 50,000 cr in FY09', March 31.

particularly software and pharmaceutical companies, on wrong footing. These companies have hedged themselves against appreciating rupee through long term forex derivatives. This led to heavy forex losses incurred by Indian companies during the quarters ended December, June and September 2008. For example, the quarter ended June 30, 2008 witnessed HCL Technologies suffering from forex losses of Rs. 278–322 crore, Tata Consultancy of Rs. 75.3 crore, Mindtree of Rs. 12.9 crore, and Biocon of Rs. 25 crore[8]. Earlier, Hexaware took a hit of Rs. 81 crore loss for the quarter ended December 2007. One estimate indicated that the total MTM losses of Indian companies on foreign exchange derivative transactions in early June 2008 stood at $3 billion to $3.5 billion and nearly 25 per cent of these losses have been accounted by small and medium enterprises (SMEs)[9].

Clearly, India's exposure to global crisis has been significant with the tightening of credit flows to economic sectors, rising cost of capital and direct financial losses incurred by Indian firms hitting their in-house resource base.

Impacts on Indian Real Sector

Belying the decoupling hypothesis that India's growth story will avoid the negative impacts of global downturn on account of her low degree of reliance on external sources of demand, the Indian economy has dropped into a slowdown in 2008. The impact of the global recession appears to have choked off India's miracle growth rate of over 9 per cent achieved during 2005–07. Consequently, its real GDP growth drops to just 5.3 per cent in the third quarter of 2008–09 (Table-1). The damage to value-added growth has been significant in the case of manufacturing with growth turning negative in the third quarter. The moderation of real growth has been associated with increasing reports of Indian manufacturing companies adopting production cuts or reduction in the number of working days in automotive, tyre, steel, textile, cement, gems and jewelry, etc[10]. Slowing of domestic and international demand and liquidity crunch have all contributed to the

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[8] *Business Standard* (2008) 'Falling rupee creates fresh losses on forex derivatives', July 18.
[9] *Business Standard* (2008) 'Forex derivatives loss at $3 bn: Fitch', June 06.
[10] *Economic Times* (2008) 'India Inc tightens belt, cuts production', October 29.

postponement and delay in the implementation of projects in a number of economic sectors.

Table-1 India's Real GDP Growth, 2005–2009

(Percentage change over previous year)

Sector	2005–07*	2007–08				2008–09		
		Q1	Q2	Q3	Q4	Q1	Q2	Q3
Agriculture, forestry & fishing	4.7	4.4	4.7	6	2.9	3	2.7	-2.2
Mining & quarrying	5.2	1.7	5.5	5.7	5.9	4.8	3.9	5.3
Manufacturing	10.5	10.9	9.2	9.6	5.8	5.6	5	-0.2
Electricity, gas & water supply	5.4	7.9	6.9	4.8	5.6	2.6	3.6	3.3
Construction	14.2	7.7	11.8	7.1	12.6	11.4	9.7	6.7
Trade, hotels, transport & communication	11.7	13.1	11	11.5	12.4	11.2	10.7	6.8
Financing, insurance, real estate & business services	12.6	12.6	12.4	11.9	10.5	9.3	9.2	9.5
Community, social & personal services	7.1	5.2	7.7	6.2	9.5	8.5	7.7	17.3
GDP Total	9.5	9.2	9.3	8.8	8.8	7.9	7.6	5.3

Note: *quarterly average; Quarters Q1, Q2, Q3 and Q4 denote April-June, July-September, October-December and January-March, respectively

Indian merchandised exports witnessed the seventh consecutive monthly drop in a row during October, 2008 to April, 2009. The 32.3 per cent fall in April, 2009 has been the sharpest fall in the last decade, declining to $10.74 billion from $16.08 billion in April, 2008[11]. The sectors witnessing significant exports losses in dollar value are gems & jewelry (-34.25 per cent in April 2009), cotton textiles including handlooms (-11.39 per cent in April–December 2008), handicrafts including carpets (-24.67 per cent in April–December 2008), finished leather (-9.22 per cent in April–January 2009), saddlery and harness (-8.12 per cent in April–January 2009), footwear components (-5.19 per cent in April–January 2009), and automobile exports (-10.04 per cent in April 2009). In the case India's IT and BPO export, NASSCOM has cut down its prediction to just 16-17 per cent growth during 2008–09 to $47 billion as against close to $50 billion estimated at the beginning of the fiscal[12].

As a result of the decline in external and internal demand led by the global crisis, the Indian economy has been estimated to suffer from significant employment losses. A sample survey conducted by the Ministry of Labour covering manufacturing (textiles,

[11] *Hindu Business Line* 'Exports decline by 33% in April', June 01.

[12] *Hindu Business Line* (2009) 'Slowdown forces Nasscom to lower export growth target this fiscal', February 05.

automobiles, gems & jewellery and metals), mining, construction, transport and BPO/IT sector, revealed an estimated half a million job loss in India between September and December, 2008[13]. This survey reported serious job loss in gems & jewelry, transport and automobiles where the employment has declined by 8.58 per cent, 4.03 per cent, and 2.42 per cent, respectively, between the said periods. The export-oriented units reported relatively more job loss than domestic market based enterprises.

Given the rising jobs losses and continuing food price inflation in India, there is a considerable probability that the poor and disadvantaged sections will be negatively impacted by the economic crisis. In the absence of the social safety net, economically and socially backward sections of the society may suffer the most as they have higher probability of job loss given their lower level of skills. With the slowdown hitting corporate earnings and the Central Government cutting central excise duties as a part of the stimulus package, the tax collection is expected to be lower for both direct and indirect taxes. This slowing growth rate of tax revenue may lead to reduced Government allocation for the social sector like education and health in the national budget.

Conclusion

This brief and preliminary survey suggests that India has been affected by the global slowdown significantly and there are possible spillovers/impacts on other sectors that are hitherto unaffected. So it is a fact that India's miracle growth is no longer insulated from happenings in the global economy with globalization ever fostering stronger bonds of financial and real economic integration between India and the rest of the world. Therefore, a greater and detail scrutiny of the impacts of Indian economy becomes an important topic of interest to public policy recently. Despite the recent signs of industrial recovery like picking of growth in infrastructure sector, return of a stable government and upbeat stock market, it is yet to be seen to what extent India can recover its lost miracle growth and withstand the global economic slowdown.

[13] Ministry of Labour (2009) *Report on Effect of Economic Slowdown on Employment in India* (October – December 2008), Government of India, Labour Bureau, Chandigarh.

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